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THE IMPACT of ELECTRONIC TAX RETURN FILING on TAX COMPLIANCE

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ABSTRACT

The relationship between e-filing and tax compliance is of interest due to the popularity of tax e-filing. Substantial prior research has shown that ethics are situation-specific, and tax compliance has been shown to be strongly influenced by personal ethics. There may be enough difference between a traditional paper tax return filing situation and an e-filing situation to impact tax filer ethics. Specifically, we investigate whether tax compliance differs across these filing methods.

Keywords: electronic tax filing, tax compliance, ethics

INTRODUCTION

Electronic filing of tax returns via the Internet (e-filing) began in 1986, and it continues to grow each year. According to the IRS, over 80 million people filed 2007 tax returns using e-file (www.irs.gov). This increase has been fueled by the IRS, tax preparers and tax filers. The IRS processes e-filed returns more quickly than paper returns, providing tax refunds in much less time. Tax preparers encourage clients to e-file because it is efficient; it reduces paperwork and tax return errors, and is less costly than paper filing (Anderson, Fox and Schwartz 2005).

The general transfer of business information electronically has expanded greatly in the past decade (Anderson, Fox and Schwartz 2005); e-filing is one example of this expansion. In addition, inexpensive tax return software with e-file capability has become widely available. These factors and others have prompted tax filers to treat e-filing as just another technology; they use it as easily as they use technology in other parts of their lives.

This paper examines whether e-filing has an impact on tax compliance. Tax compliance is the accuracy of a tax payer's filing, reporting, and payment of income taxes (www.irs.gov). We investigate whether tax compliance is lower when a tax return is to be filed electronically than when a return is to be filed in paper form. Tax compliance has been shown to be strongly influenced by personal ethics, and research has shown that ethics are situation-specific. There may be enough difference between a traditional paper tax return filing situation and an e-filing situation to impact tax filer ethics.

PRIOR LITERATURE and HYPOTHESIS DEVELOPMENT

Tax compliance is a continuing problem in the United States. Porter and Wood (2005) report the national 'tax gap' – the difference between taxes owed to the government and those collected- was already in the billions of dollars. Many factors impacting tax compliance have been studied, including the presence/absence of audits, tax inequity and peer reporting behavior (Trivedi, Shehata and Lynn 2003); friendly persuasion, gender (Chung and Trivedi 2003); threat of detection, severity of punishment (Wiegel, Hessing and Eiffers 1987); threat of punishment (Hanno and Violette 1996); personal ethics (Wenzel 2005), and morality and risk aversion (Eisenhauer 2008).

There is general agreement that personal ethics are influenced by situational factors (e.g. Smeyers 1999; Swaidan, Vitell and Rawwas 2003). In addition, individuals' attitudes and beliefs vary among laws (Henderson and Kaplan 2005). For example, Song and Yarbrough (1978) found that taxpayers felt tax evasion was a quite minor crime, ranking it only slightly more serious than stealing bicycles.

One element of the e-file situation that may impact tax compliance is the electronic transfer of information. E-file may seem less real to the taxpayer because they see the return being filed only through a computer printout. Perhaps signing the return electronically rather than physically implies less responsibility for the signature, or the fact that the IRS promises faster tax refunds for e-filings implies these returns get less scrutiny. Possibly, tax preparers' advocacy of e-filing implies these returns are less likely to cause the tax payer trouble.

In each of these ways, the tax filer may be given the impression that e-filing is different than paper filing. Some situational exigencies may temper taxpayers' ethical values (Reckers, Sanders and Roark 1994), and e-filing may be such a circumstance if the filing method is a crucial feature of the tax filing situation. Taxpayers who feel less connected to e-filed returns, or feel less responsible for their details when e-filing, may be more likely to commit tax evasion. Our hypotheses (in null form) are:

H1: Taxpayers believe tax returns filed electronically receive the same level of scrutiny by the IRS as tax returns filed on paper.

H2: Taxpayers believe income not reported on an e-filed return is as likely to be detected by the IRS as income not reported on a paper-filed return.

H3: Taxpayers believe the speed of processing e-filed returns has no implication for the level of IRS investigation of those returns.

In other words, tax compliance decisions may be impacted by filing format. Prior research on tax compliance has not investigated the impact of this variable.

Ethical evaluations represent one's ethical beliefs specifically about and in the context of a decision. Therefore, ethics which are specific to the tax reporting situation impact tax compliance (Reckers, Sanders and Roark 1994).

Ethics related to tax reporting have been measured in several ways, including using the multidimensional ethics scale (MES) of Reidenbach and Robin (1990). Under the MES, individuals' ethical decisions are partly based on three facets of ethics: moral equity (whether the act is morally right, fair, just), relativism (whether the act is culturally, traditionally acceptable) and contractualism (whether the act complies with unwritten, unspoken promises of society). Henderson and Kaplan (2005) found that while all three

dimensions impacted tax compliance, the moral equity dimension dominated the other two dimensions for tax compliance.

Moral equity is based on the context of a decision. If the e-filing context differs from the paper filing context, the level of moral equity may be different in the two situations.

Our hypotheses (in null form) regarding moral equity are:

H4: The level of moral equity is lower in the e-filing situation than the paper-filing situation.

H5: The level of moral equity is positively related to the level of tax compliance.

METHOD

Measurement Instruments

Three instruments will be used to gather data. First, we have developed a survey regarding general past experiences with e-filing and attitudes toward IRS treatment of e-filed returns. Second, we will measure tax compliance attitudes by modifying a survey instrument first reported in Kaplan, Newberry and Reckers (1997). Third, we will measure moral equity using the concise version of the MES from Reidenbach and Robin (1990). Participant replies to the four elements of this measure will be combined into one measure of moral equity.

Participants

Participants in the e-filing versus paper filing portion of the study will be VITA program will be taxpayers attending a VITA site conducted by one of the authors. Participants in the moral equity – taxpayer compliance portion of the study will be 200 accounting majors who have completed at least 12 hours of accounting courses, and at least half of an introductory course in tax accounting.

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